I am an accountant, tax agent and auditor and conduct an arts-based practice, providing services to individual artists, arts organisations and Aboriginal art centres. The practice was established in 1980 and has clients across Australia, engaged in all forms of arts endeavours, from emerging to established, and, as tax matters go, from the ill informed to the well versed. Our experience with artists (individually or as part of an entity), arts organisations and art centres for almost thirty years has allowed us to see, first hand, the effects of the taxation system, in its various incarnations, for good and for bad. In this submission I hope to draw your attention to the ways in which the system has impacted badly on the arts community, and suggest some amendments that might ameliorate some of these problems.

There are four matters of concern:

1 The operation of the Non-commercial loss provisions
2 Deductibility of contributions to superannuation funds by self-employed taxpayers
3 Income averaging provisions
4 Deductions for travelling expenses

1 The operation of the Non-commercial Loss Provisions

This legislation was enacted as part of The New Tax System and operated to quarantine business losses derived from an activity that did not satisfy one of four tests, the two most relevant being a requirement that the business had a turnover of at least $20000, or that in the loss year there had been a profit in the preceding three years. The arts community rightly understood the ramifications of these provisions, namely, that emerging artists would effectively have their losses quarantined until they were well established, and that the cash flow benefits (used to fund the arts business) from deducting the loss against other income would be lost.

The proposed legislation was then subsequently amended to provide that artists (and primary producers) would not be required to satisfy the tests in order to obtain a tax deduction that year. Unless their income from other sources exceeded $40000 in which case the tests would have to be satisfied.

For an artist earning other income of less than $40000 there is no problem, but for those earning over that threshold there is because they are unlikely, in the early years of their arts career, to satisfy the profit test or the turnover test.

Examples of those adversely affected include a nurse who is developing a film production business and works night shifts to allow her to engage in her film-making during the day, when most producers and other film makers will be available. Luckily, or unluckily, it doesn't take too many nights to get to the threshold and if she's watching her payslips she reaches a point where a decision has to be made; keep working and lose the deduction, or stop working and secure the refund. The film production business is certainly gaining momentum, but she's still tipping in her own wages so technicians, writers, suppliers and post-production houses can be paid. It is worth noting that the $40000 threshold has not been increased since the legislation was passed in 2000.

Another common example would be a visual artist, musician, writer or performer whose day job is lecturing at a tertiary institution in that subject. The employment contract will invariably require that the lecturer maintains a profile as a practitioner (which helps to sell the course to prospective students) but in this case the lecturing income, while inextricably linked to the artist's practice, is considered to be, in fact, "other" and unrelated income. The business losses are consequently not deductible in that year. A visual artist whose dealer or gallery operates on a consignment sale basis rather than on a commission on sale basis, will have to sell maybe fifty percent more works before they get to the $20000 threshold because for them sale value is what the gallery paid, not what the ultimate buyer paid. For artists whose employment is so closely related to their practice, many expenses could be classified as both work related and business. For these there is a further dilemma; if they expect work income to exceed the $40000 threshold they may be tempted to treat more of their expenses as work related and ensure deductibility, but that means foregoing any claim for Input Tax Credits. If they think other income is going to be less than the threshold they would treat the expenses as business and claim the GST. If, however, the end of the year comes and they exceeded the threshold after all then the deduction is denied – unless they "change their mind", treat the expenses as work related after all, and amend their BAS and repay the GST, possibly with interest added.

Given that most artists *have* to work at a job to fund their fledgling business, it is difficult to understand why the income threshold should be so low, or why it should be there at all, given that negative gearing for property and shares have no such restrictions.

The other test is the profit in three out of five years rule. One could understand the logic of this if the operation of the rule allowed a loss in the first year, a loss in the second year, but a loss in year three would be quarantined because now the three out of five test could not be satisfied, but no, the rule requires the profits to be made up-front. This flies in the face of all accepted wisdom, that start-up businesses are more likely to lose money in the early years. You can almost hear the congratulations all round as the drafters of the legislation point to the phantom concession they've just created. Smoke and mirrors indeed.

While the exemption from the tests applies to artists (earning le*ss* than $40000) it does not apply to others who work in the arts but are not considered artists themselves. Examples include DJ's (who are really are a mixture of performer and musician), curators, operators of Artist Run Initiatives/Spaces, people who start up cultural festivals, people who start a business managing emerging musicians and bands. While their activities, involvement, prospects and livelihood are arts based, they are not seen as artists and so do not enjoy even the limited benefits of these provisions.

Recommendations:

That either the $40000 other income rule be set aside, or for those working in a closely related discipline, that that income not be counted as other income, or that it count as arts income for the purposes of the turnover test;
that the other income threshold, if retained, be indexed;
that the definition of an arts business be expanded, and
that the three years out of five rule be either set aside, or amended to allow losses in the first two years of an arts business.

2 Superannuation Contributions for the self employed

One of the more peculiar aspects of income tax law (and there are many) is the assertion that anyone earning more than 10% of their assessable income in a PAYG situation is regarded as not being self employed and therefore not entitled to a tax deduction for personal superannuation contributions. 10%!! If it was the other way around, fair enough, but 90% of your income comes from business and you're *not* self employed? Even Kafka would blush at that! For artists who may pick up a bit of employment here and there, superannuation as a tax deduction is not an option; and we're trying to encourage people to save for their retirement?

I have seen cases where a prudent and mindful-of-the-future artist will put aside some of their, often meagre, earnings into superannuation. July to May; everything is going well, then an irresistible casual job comes up. It'll only be for three weeks, but in those three weeks they earn 10.5% of their annual assessable income and now their tax deduction has disappeared into more smoke and mirrors. For all mixed employment/waged taxpayers, this is the most effective way to discourage them from providing for their future. One would expect the test to be "more than 50%" in the same way that someone is regarded as an employee if more than 50% of their fee is for the provision of labour.

Visual artists, and others producing tangible goods, might also benefit from a relaxation of the rules governing the transfer of personal assets into a superannuation fund, commercial real estate and shares in publicly listed entities excepted. If artists could transfer into either a Self Managed Superannuation Fund, or a Public Fund established for that purpose, works created during their career, and get a tax deduction for the market value of the work at that time, then they would have a pool of investment assets which could be progressively realized, free of Capital Gains Tax, on their retirement. The superannuation fund could lease the works or sell works, but at least the revenue and gains would be taxed on a concessional basis and the funds would remain “locked up” in the superannuation fund.

Recommendations

That the assessable income from business required to meet the self employed test for deductibility of superannuation contributions be reduced to less than 50% of total assessable income, and
that consideration be given to allowing artists a tax deduction for the market value of works transferred to a complying superannuation fund

3 Income Averaging Provisions

The benefits of income averaging have declined as tax brackets have widened but for early career artists the benefits are still valuable.

The averaging provisions, however, tend to benefit those engaged in what might be broadly referred to as the creation of intellectual property rights. This has the effect of excluding those engaged in arts activities but who are not necessarily creators in the sense that they produce a painting or a piece of music or literary work. As I noted above, they do not benefit from the application of the Non-Commercial Loss Provisions, but their income is subject to the same fluctuations as the artists themselves. Someone setting up a business as a band manager will find their income, its ups and downs, closely paralleling that of the bands they manage.

Recommendation

That the definition of artist be extended to cover those working in the arts in arts related activities.

4 Deductions for Travelling Expenses

There are many reasons why, for example a band, will incorporate their business, and it generally has less to do with the company tax rate of 30% - since most of their earnings will be taxed at that, or less – than it has to do with the deduction for per diems. An artist employed by a company can receive, tax free and without need for documentation (beyond that needed to demonstrate that travel took place) a daily allowance to cover meals, accommodation and incidentals. The same musician, self employed or in a partnership, will be required to keep receipts and other documentation for every claim they wish to make. Their circumstances are identical, yet effectively one gets a deduction at a set rate with no documentation, the other, a deduction for whatever paperwork they’ve managed to get, and not lose, on the tour.

Recommendation

That the deductibility of Daily Travel Allowances and Living Away From Home Allowances be extended to those travelling on business while self employed.

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